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FEATURED | Post-Sanctions Iran: China-Inspired Dream, Soviet-Style Collapse, or Something Else?

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By Philip Gater-Smith

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Iran's nuclear deal with the six major world powers, implemented in January 2016, has fueled much speculation both inside and outside Iran. Many are hopeful that the lifting of multilateral sanctions will serve to assuage the decade-long animosity stoked by Iran's nuclear program. For most Iranians, the removal of sanctions offers an economic lifeline, a possible end to political pariah status, and a re-integration into the global economy. For Americans, Europeans, and Asians, it offers a potential solution to, or deferment of, a pressing security concern, as well as presenting enticing business opportunities. Furthermore, a Western-Iranian détente could well serve as a stabilizing force across the greater Middle East.

So far, however, not much has changed. The uncertainty of Iran's economic and political future has led both Iranians and Westerners to envision an array of possible scenarios. While Iranian hardliners are largely interested in maintaining the economic and ideological status quo, many young, urban Iranians desire a secular, democratic, capitalist future. For others, the "China Model" – economic opening, but continuing political authoritarianism – offers an inviting roadmap. Still others see the country following in the Soviet Union's footsteps toward economic stagnation and eventual regime collapse.

To understand these visions, it is helpful to outline Iran's basic economic, political, and social structures and to view recent developments within these contexts.

Economic Challenges

In 2013, reformist Hasan Rouhani was elected president, based on his promises to end the nuclear dispute and to fix the Iranian economy. The only noteworthy improvement since then has been a significant decrease of inflationary pressures. Since 2014, however, the falling price of oil has caused the GDP to decline, increasing fiscal pressures from a 1.2 to 2.7 percent deficit of GDP a year later. Additionally, this has resulted in the decline of current account surplus from 3.8 percent to 0.6 percent of GDP during that year. Job creation for the country's young population is desperately needed to avert future recessions and to quell potential unrest.

Although Iran is the Middle East's second largest economy (after Saudi Arabia), and is second largest in population (after Egypt), these favorable conditions have not been sufficiently leveraged since the signing of the JCPOA. Iran is significantly reliant on the hydrocarbon sector; its agriculture and service sectors are modest performers at best; and its manufacturing and financial services industry is heavily dominated by the public sector.

The Rouhani administration is seeking to re-boot the economy with a five-year plan, aiming for ambitious eight-percent growth rates as a first step. Intended reforms include privatization of some industries that have long been in the hands of the public sector as well as the slashing of some unproductive subsidies. Moreover, targeting the country's high level of corruption, as well as easing the complicated regulatory framework, are central to Rouhani's goal of attracting foreign direct investment (FDI).

First and foremost, Rouhani's administration is seeking to inject Western and Asian capital, technology, and expertise into Iran's aged oil and gas industries. Iran holds the fourth-largest crude oil reserves in the world, and the second largest natural gas reserves. Relying on energy exports is Rouhani's short-term instrument for boosting desperately needed growth. But this strategy will not be fully effective as long as the price of oil remains low. Yet if the country's 2016/17 GDP visibly improves (the World Bank predicts a figure between 4.2 and 4.6 percent), Rouhani hopes to later implement further reforms and diversification, pending his re-election in 2017.

Political Challenges

Re-election will be a challenge in its own right. For the moment though, Rouhani's course has been democratically vindicated by the relatively clean February 2016 elections within two of Iran's core political institutions. Both the Majlis, Iran's parliament, and the Assembly of Experts, Iran's clergy elite responsible for choosing the potential successor to the elderly Supreme Leader Ayatollah Ali Khamenei, saw the victories of relatively "moderate" and reform-minded candidates. This popular mandate should enable Rouhani to push through at least some of his economic reforms.

However, the political obstacles are serious and numerous. Even though Iran's political and religious hardliners, including Khamenei, cautiously supported Rouhani's directly related goals of settling the nuclear dispute and reviving the economy, that backing has largely faded since the nuclear deal's successful passage in 2015. The deeply conservative clergy and its military backbone, the Iranian Revolutionary Guards Corps (IRGC) – the regime's central institutions – have always held quite different

ideas on what these goals entail and what should follow.

Khamenei and his entourage intend for Iran to build what they call a “resistance economy”. Ironically, their focus is on diversification and the non-oil industry. This reason is two-fold. First, to avoid a substantial inflow of largely Western FDI into what would mostly be the oil and gas industry, and the inevitable wider Western economic and cultural influence that would accompany it, the Ayatollahs see relative autarky as the only way to preserve the country’s – and the regime’s – Islamist outlook and system. Regime survival and the country’s ideological “purity” are closely connected and represent their most important objective. Second, the clergy elite, and especially the IRGC, which hitherto have enjoyed the benefits of controlling the country’s key industries, have much to lose in a non-sanctioned and non-protectionist Iran. Vast FDI inflows would break up their monopolies. Conversely, their image of a self-reliant “resistance economy” would directly shield not only their businesses from foreign competition, but also the entire country from possible future economic sanctions.

Therefore, hardliners in Tehran are trying to sabotage Rouhani’s comprehensive reforms using several tactics. Domestically, the mass disqualification of the most modernist reformers prior to the Majlis and Assembly elections was meant to cushion the magnitude of some inevitable reforms. Abroad, the IRGC is seeking to drive wedges between Rouhani’s administration and the United States, as demonstrated by recent ballistic missile tests and the January 2016 U.S.–Iran naval incident.

Iran’s conservative elite with their entrenched interests present one set of formidable obstacles for Rouhani’s ideas. Despite his popular mandate, he cannot afford to completely disaffect Khamenei and the IRGC without the risk of becoming a “lame duck” president like his hawkish predecessor. For this reason, he is choosing his battles cautiously, refraining from doing too much, too fast, in order to implement at least some changes and promote short-term growth. Rouhani has shied away from overhauling the entire economic system with radical reform or with political and social liberalization - such as increased freedom of press and the active promotion of women’s rights, which many inside and outside the country see as vital. Indeed, given his own religious background, it is even questionable that he himself would desire the level of change for which the secular, urban youth yearns.

From the opposite side, Washington’s maintenance of unilateral sanctions on Iran, which are largely related to Iran’s sponsorship of regional terrorist groups and human rights abuses, comes with a second set of obstacles. These sanctions continue to cut Iran off from American financial markets and dollar-denominated international transactions. By legally preventing major U.S. banks from dealing with the Islamic Republic, the sanctions further pose a high risk for foreign companies investing in Iran. This also explains the ongoing absence of ventures, especially American, in the country.

To counter the growing criticism which Rouhani faces at home, the Iranian president has adopted the hard-liners’ rhetoric of the “resistance economy”. One can interpret this as merely lip service to his powerful domestic opponents. Rouhani needs to garner at least some passive support and to legitimize his policies vis-à-vis Iran’s diverse popular electorate. Again, however, his vision of a comprehensive integration of Iran into global markets is fundamentally at odds with a “resistance economy”. By using this terminology and linking it to his own economic ideas, Iran’s president is seeking to overtake the hardliners on the other side. Rouhani’s argument assumes that protection from possible future sanctions on Iran is more likely to originate from the country’s global economic re-integration. The potential outside investor countries would have much to lose from new sanctions, thus making them more difficult to impose.

However, Rouhani is running out of time. Given the risk of a Trump victory and its uncertain consequences for the JCPOA, the Iranian administration needs to quickly implement reforms. The Islamic Republic’s own presidential election in 2017 will require Rouhani to demonstrate positive results from his reconciliatory policies and his promises to fix the Iranian economy. Given all these challenges, which scenarios are most likely?

A Messy Future for Iran's Polity

Due to the Islamic Republic's political and social diversity, and the resulting deep divisions within both Iran's government institutions and the entire populace, a peaceful revolution leading to a secular, tolerant, and democratic future appears unlikely in the short-term.

While the current reformists do act in opposition to the hardliners, they remain nonetheless religious conservatives. Stemming largely from the old guard, most of these reformists are suspicious of the West. Their priority is economic growth and relative regional stability, which explains their willingness to settle conflicts with the United States. Given the reformists' economic focus, some are flirting with the "China Model" (or the "China Dream"), which would see Iran's integration into the global, capitalist economy, but would resist Western-style political and social liberalization.

Larger obstacles, however, loom before this vision. Having seen China's own ideological change over the last decades, Iranian hardliners would be resistant, fearing similar cultural "erosion". Their idea of a "resistance economy" is the opposite of China's. Furthermore, broader Middle Eastern security issues and political risks, as well as ongoing U.S.-Iranian hostility, complicate the analogy. Last but not least, the Islamic Republic's secular urban youth is better educated and politically more liberal and engaged than China's old generation, which largely accepted the Communist Party's enduring authoritarian rule. The young Iranian generation, which will take over the elite positions occupied by the aging Ayatollahs and their cronies, might be unwilling to accept a Chinese-style lack of political openness.

Does this mean that Iran will at some stage witness a Soviet-style regime collapse, as suggested by former Deputy Assistant Secretary of State for Iran, John Limbert, or by Ray Takeyh of the Council on Foreign Relations? Is Rouhani the Iranian Gorbachev? Once timid reforms kick in, will the floodgates open as they did in Eastern Europe in 1989? Admittedly, there are some parallels, but also important differences. Iran's hardliners are and will be equally resistant to a comprehensive "perestroika" (economic opening), just as the U.S.S.R.'s hardliners were at the time. However, Iran's strongmen seem significantly more hostile to an Iranian "glasnost" (political opening) than were the disillusioned and lethargic Soviet elite prior to the Cold War's end. The notion of a Prague Spring in Tehran seems fanciful given that Islamist ideology is as alive as ever. Revolutionary attempts for Iranian regime change are likely to be met by a violent crackdown that could make the 2009 crushing of the Green Movement seem trivial.

Iran's short-term future depends on Rouhani's current reform attempts, the upcoming American and Iranian elections, as well as on regional issues such as Daesh ("Islamic State"), the future of Syrian President Bashar al-Assad, sectarianism, and Saudi-Iranian relations. Depending on developments in these areas, none of the above scenarios is likely to occur in the near future.

Outlook for Iran's Economic Re-Boot

Undoubtedly, the American and Iranian elections will be the first and second major harbingers for the near future. On balance, a Clinton victory is the most likely. Therefore U.S. strategy towards Iran is unlikely to experience major change. Clinton would probably loosely continue Obama's cautiously flexible approach. She would want the JCPOA to pay off, but would not lift unilateral sanctions unless Iran withdraws its support for regional specific regional militant groups. Given that the latter are the IRGC's domain, this is unlikely.

Only the lifting of American sanctions though would enable game-changing Iranian economic restructuring and growth. A comprehensive transformation of Iran's economy and its political institutions is therefore unlikely to occur before the Iranian elections in 2017.

Even if Rouhani does win re-election, he will face much higher pressure in a second term to deliver if the president is to avoid leaving the electorate disillusioned while again empowering hardliners seeking to turn him into a "lame duck". Such a scenario would not help Iran's FDI climate and it would dampen many of Iran's economic prospects and business opportunities. Furthermore, this outcome would not bode well for the reconciliation between the West and Iran, nor stability across the Middle East.

About the Author:

Philip Gater-Smith is a U.K.-based Middle East analyst who focuses on China's economic relations with the GCC and Iran.

